

**Internal Revenue Service  
Director, Exempt Organizations**

**Department of the Treasury  
P.O. Box 2508  
Cincinnati, Ohio 45201**

**Date: July 15, 2011**

**Number: 201140029**

**Release Date: 10/7/2011**

**Employer Identification Number:**

**Person to Contact - ID#:**

**Contact Telephone Numbers:**

Phone

Fax

**UIL**

**4942.03-07**

**LEGEND**

B = State  
p = Amount  
q = Amount  
r = Amount

Dear :

You have requested a ruling that a set-aside in the amount of p dollars for the taxable year ending October 31, 2010, meets the requirements of Section 4942(g)(2)(B)(i) and accordingly constitutes a qualifying distribution under section 4942(g).

**FACTS**

You are a corporation formed under the laws of the state of B, exempt from federal income tax under section 501(c)(3) of the Code, and have been determined to be a private operating foundation under sections 509(a) and 4942(j)(3).

You have set aside p dollars for the purpose of carrying out necessary improvements to your facility and to improve the drainage of the land on which it stands. The facility is used exclusively for carrying on your exempt activities; a museum occupying the second floor and public meeting rooms on the ground floor. The facility contains no administrative offices. The building is over 75 years old. You have determined that there is a significant loss of energy through the single pane windows, resulting in higher heating and cooling costs. You will replace all of the external windows with energy-efficient windows. Many of the windows have to be custom-made due to their dimensions, so that the entire project cannot be completed before the end of your current fiscal year. The estimated cost of this project (Project 1) is q dollars. The

window replacements are expected to be completed in the first quarter of your next fiscal year. The land surrounding the building is farmland. The contour of the land is such that drainage is a problem in periods of heavy rainfall. In the spring you will build a drainage ditch with runoff pipes and grates to prevent flooding of the facility grounds. The estimated cost of the drainage project is r dollars. All of the work will be completed before the end of your next fiscal year. These outlays are significant in relation to your normal annual operating income and expenditures, and will require an accumulation of income. Moreover, your Board has determined that given the age of the building it would not be prudent to pay the contractors until the work is substantially under way.

No additions to the set-aside for this project are contemplated.

## **LAW**

Section 4942(g)(1) of the Code defines "qualifying distribution" as (a) any amount paid to accomplish one or more purposes described in section 170(c)(2)(B), other than any contribution to (i) an organization controlled by the foundation or one or more disqualified persons, or (ii) a private foundation which is not an operating foundation, except as otherwise provided; (b) any amount paid to acquire an asset used directly in carrying out one or more purposes described in section 170(c)(2)(B).

Section 4942(g)(2)(A) of the Code provides that, for all taxable years beginning on or after January 1, 1975, an amount set aside for a specific project within one or more purposes of section 170(c)(2)(B) may be treated as a qualifying distribution if the amount meets the requirements of section 4942(g)(2)(B).

Section 4942(g)(2)(B)(i) of the Code provides that an amount set aside for a specific project may be treated as a qualifying distribution if, at the time of the set-aside, the foundation establishes to the satisfaction of the Secretary the amount set aside will be paid for the specific project within five years, and the specific project is one that can better be accomplished by the set-aside of income rather than by the immediate payment of funds (the "suitability test").

Section 4942(j)(3) of the Code requires that private operating foundations must spend at least 85% of its adjusted net income or its minimum investment return, whichever is less, directly for the active conduct of its exempt activities (the income test) in order to remain a private operating foundation.

Section 53.4942(a)-3(a)(2)(iii) of the Foundation and Similar Excise Tax Regulations defines as a qualifying distribution any amount set aside within the meaning of paragraph (b) of section 3.

Section 53.4942(a)-3(b)(1) provides that the amounts of income set aside for a specific project for one or more of the purposes in section 170(c)(1) or 170(c)(2)(B) of the Code may be treated as qualifying distributions for the tax year(s) in which such amounts are set aside (but not in the tax year in which actually paid) if the requirements of section 4942(g)(2) and paragraph (b) are satisfied. The requirements of paragraph (b) are satisfied if the foundation establishes to the satisfaction of the Commissioner the amount set aside will be paid for the specific project within 60 months after it is set aside, and (i) the set-aside otherwise meets the suitability test of section 53.4942(a)-3(b)(2) or (ii) the foundation satisfies the cash distribution test.

Section 53.4942(a)-3(b)(2) provides that the suitability test for a set-aside is met if the foundation establishes the specific project is one in which relatively long-term grants or expenditures must be made in order to assure the continuity of particular charitable projects or program-related investments, for example, a plan to erect a building to house a direct charitable, educational, or other similar exempt activity of the foundation.

Section 53.4942(a)-3(b)(7)(i) provides that a private foundation must obtain Internal Revenue Service approval of its set-aside of income under the suitability test by applying before the end of the tax year in which the amount is set aside.

In Revenue Ruling 74-450, 1974-2 CB 388, the term "specific project" as defined in section 53.4942(a)-3(b)(2) of the Excise Tax Regulations was held to include an operating foundation's conversion of a portion of newly acquired land into an extension of an existing wildlife sanctuary and the remainder into a public park under a four year construction contract, under which payments were made mainly during the last two years.

## **ANALYSIS**

You have sought timely approval of your set-aside of income in accordance with Section 53.4942(a)-3(b)(7)(i).

As required by Section 4942(g)(2)(A) of the Code and Section 53.4942(a)-3(b)(1) of the Regulations, your proposed set-aside will be used to accomplish purposes described in section 170(c)(2)(B) of the Code, namely, for improvements to the facility you use in carrying on your educational activities and ameliorization of drainage in the vicinity of the facility.

The amount set-aside for this specific project will be paid out within 60 months from the set-aside, as required by section 4942(g)(2)(B)(i) of the Code and section 53.4942(a)-3(b)(1) of the regulations.

Your project is one that can better be accomplished by the set-aside of income rather than by the immediate payment of funds. Given the age of the building and your previous experience with general contractors, your Board has decided it would be more prudent not to pay the contractor awarded the window replacement project until the windows have been delivered and the work is substantially underway. For the same reason, the Board does not judge it prudent to advance any money to the contractor of the drainage project until the work is actually commenced. Like the private operating foundation in Revenue Ruling 74-450, you are under the necessity of accumulating your current year's income to be able to make the disbursements for the project which will fall due in the next accounting period.

Your project therefore satisfies the suitability test as set forth in Section 4942(g)(2)(B)(i) of the Code and Section 53.4942(a)-3(b)(2) of the Regulations.

## **RULING**

Based on the foregoing, The set-aside of p dollars for the taxable year ending October 31, 2010, meets the requirements of Section 4942(g)(2)(B)(i) and accordingly constitutes a qualifying distribution under section 4942(g).

We direct your attention to Section 53.4942(a)-3(b)(8) of the regulations, entitled "Evidence of Set-Aside." This section provides that any set-aside approved by the Internal Revenue Service shall be evidenced by the entry of a dollar amount in the books and records of a private foundation as a pledge or obligation to be paid at a future date or dates. Further, the amount of the set-aside must be taken into account in determining the foundation's minimum investment return (see section 53.4942(a)-2(c)(1) of the regulations), and any income attributable to a set-aside must be taken into account in computing adjusted net income (see section 53.4942(a)-2(d) of the regulations).

This ruling is based on the understanding there will be no material changes in the facts upon which it is based. Any changes that may have a bearing on your tax status should be reported to the Internal Revenue Service. This ruling does not address the applicability of any section of Code or regulations to the facts submitted other than with respect to the sections described.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose*. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling letter is directed only to the organizations that requested them. Section 6110(k)(3) of the Code provides that they may not be used or cited as precedent.

Please keep a copy of this ruling letter in your permanent records.

If you have any questions about this ruling, please contact the persons whose name and telephone number are shown above in the heading of this letter.

Sincerely yours,

Lois Lerner  
Director, Exempt Organizations

Enclosure:  
Notice 437